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No. 86-_____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

A & E SUPPLY COMPANY, INC.,
Petitioner,

v.

NATIONWIDE MUTUAL FIRE INSURANCE COMPANY,
Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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QUESTIONS PRESENTED

1. Did the Court of Appeals misapply this Court's decision in *Neely* v. *Martin K. Eby Construction Co.*, 386 U.S. 317 (1967), in the instant case, where petitioner won a jury verdict in a diversity action in the district court and the trial judge denied respondent's motions for judgment n.o.v. and a new trial, by ordering judgment for respondent without affording petitioner a new trial on a cause of action which the trial court stated had been mistakenly taken away from the jury?

2. Did the court of appeals deny petitioner its right to a jury trial in the instant case, where the trial judge concluded at the end of trial that a cause of action had been mistakenly taken away from the jury, by ordering judgment for respondent rather than remanding the case to the trial court?

3. Did the court of appeals violate the *Erie* doctrine developed by this Court by refusing to give petitioner a new trial following an ambiguity in the jury verdict for petitioner when the governing state law clearly provided that the verdict winner should have the opportunity for clarification?

PARTIES BELOW

The following entities were parties to the proceeding in the United States Court of Appeals for the Fourth Circuit, the court whose judgment is sought to be reviewed:

A & E Supply Company, Inc.
Nationwide Mutual Fire Insurance Company

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OPINION BELOW

The district court's opinion holding that respondent waived its arson defense to the contract claim is reported at 589 F.Supp. 428 (W.D. Va. 1984). The district court's opinion denying respondent's post-trial motions for judgment n.o.v. and a new trial is reported at 612 F.Supp. 760 (W.D. Va. 1985). The court of appeals' opinion reversing the district court's entry of judgment on the punitive damage verdict and denying petitioner punitive damages is reported at 798 F.2d 669 (4th Cir. 1986) and is reproduced herein at Appendix 1a.

JURISDICTION

The judgment sought to be reviewed by writ of certiorari was dated and entered August 15, 1986. The court of appeals' order denying petitioner's request for rehearing and rehearing *en banc* was entered and filed September 26, 1986 and is reproduced herein at Appendix 20a. The statutory provision conferring jurisdiction on this Court to review the judgment in question by writ of certiorari is 28 U.S.C. § 1254(1) (1982).

FEDERAL RULES INVOLVED

Rule 50. Motion for a Directed Verdict and for Judgment Notwithstanding the Verdict

(d) Same: Denial of Motion. If the motion for judgment notwithstanding the verdict is denied, the party who prevailed on that motion may, as appellee, assert grounds entitling him to a new trial in the event the appellate court concludes that the trial court erred in denying the motion for judgment notwithstanding the verdict. If the appellate court reverses the judgment, nothing in this rule precludes it from determining that the appellee is entitled to a new trial, or from directing the trial court to determine whether a new trial shall be granted.

STATEMENT OF CASE

A & E Supply Co., Inc., petitioner herein, filed suit in the Circuit Court for Buchanan County, Virginia, alleging that respondent, its insurer, wilfully and in bad faith refused to honor its fire loss claim following a fire totally destroying petitioner's warehouse and inventory. Respondent removed the action to the United States Dis-

trict Court for the Western District of Virginia.[1] Petitioner filed an amended complaint prior to trial alleging, *inter alia*, breach of contract, conversion, fraud, slander, bad faith dishonor of a first-party insurance obligation, and violation of the Virginia Unfair Insurance Practices Act, 6A Va. Code § 38.1-49, *et seq.*

The case was tried before a jury after the trial court held that respondent had waived any arson defense to the contract claim by its inconsistent payment to a "co-loss payee" in contrast to its refusal to pay petitioner.[2] Petitioner conclusively established that respondent never intended to honor the contractual claim even though it had no reasonable ground to decline payment. Petitioner also proved that respondent sent letters to its bank and various suppliers falsely accusing petitioner of arson with the intent to pressure it into settling the claim for less than the policy limits.

At the close of petitioner's evidence and again at the close of all the evidence, respondent moved for a directed verdict. The trial judge denied respondent's motions and submitted the case to the jury after first directing a verdict for petitioner on the stipulated value of the warehouse. The trial judge instructed the jury that if petitioner "is entitled to be compensated for its damages,"

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[1] As the Court will see, the fact that the action was removed effectively determined the outcome of the case. The court of appeals refused to follow state law preserving a verdict winner's right to a new trial when an appellate court finds an ambiguity in a jury verdict. The result reached by the court of appeals could not have occurred had this case remained in state court.

[2] This was a state law issue, and the trial court's ruling, reported at 598 F.Supp. 428 (W. D. Va. 1984), was never challenged by respondent.

then the jury "may also" award punitive damages. The jury returned the directed verdict for the structural coverage and a general verdict for the maximum inventory coverage under the policy totaling approximately $221,000.00. The jury also returned a special verdict awarding $500,000.00 in punitive damages finding that respondent acted in bad faith by committing the torts alleged and that the effect of respondent's conduct was to drive petitioner out of business.

Respondent then moved for judgment n.o.v. or, alternatively, for a new trial. The trial judge denied both motions in his memorandum opinion carefully reviewing all of the evidence and the uncontroverted facts supporting the jury verdict. 612 F.Supp. 760 (W.D. Va. 1985).[3] The trial court entered judgment on the verdict finding that petitioner proved respondent acted in bad faith[4] and converted petitioner's business records to prevent it from garnering the necessary evidence to successfully litigate the disputed value of its inventory claim.

The trial court further concluded in its post-trial memorandum that

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[3] The trial court granted respondent's motion for judgment n.o.v. on the fraud count because petitioner failed to prove it by clear and convincing evidence. The trial court also found that respondent violated the Virginia Unfair Insurance Practices Act, 6A Va. Code § 38.1-49, *et seq.*, but conditionally awarded petitioner a new trial because it erroneously excluded evidence of repetitive violations required by the statute.

[4] The trial court stated that "[i]f there has ever been a case in which the facts justify a finding of bad faith by an insurance company adjusting a fire loss, this is the case. The evidence is almost undisputed that [respondent] acted in bad faith in handling [petitioner's] claim." 612 F. Supp. at 772.

> [a]mong the separate, independent, wilfull torts pled by [petitioner] in the amended complaint was the tort of slander. The court denied the motion to allow the allegation of slander because it was not mentioned in the original suit. Slander was proven by strong evidence [under general allegations of bad faith] and the court is now of the opinion that error was committed by not permitting [petitioner] to amend its complaint in view of the change made by the *Kamlar* decision.[5] There was undisputed evidence that [respondent] told creditors that [petitioner] had deliberately burned its building to collect on the insurance policy. It was further shown that this slander was damaging to [petitioner], preventing the commencement of any new business and severely limiting its ability to obtain credit.

612 F.Supp at 762, n.1.

The trial court had no occasion to embody these findings in a directed verdict for petitioner because it sustained the jury verdict awarding everything requested in the amended complaint and entered judgment on the verdict. But, the trial court's opinion is clear that it viewed these matters as undisputed.

Respondent appealed, claiming that its motion for judgment n.o.v. should have been granted. The court of appeals held as a matter of first impression that the Virginia Supreme Court would not recognize the tort of bad

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[5] *Kamlar* referred to the Virginia Supreme Court's decision in *Kamlar Corp.* v. *Haley*, 224 Va. 699, 299 S.E.2d 514 (1983), which was decided after petitioner's suit was originally filed. The Virginia Supreme Court held in *Kamlar* that punitive damages may be recovered for breach of contract where the breach amounts to an independent, wilful tort. 224 Va. at 705, citing *Wright* v. *Everett*, 197 Va. 608, 615, 90 S.E.2d 855, 860 (1956).

faith dishonor of a first-party insurance obligation.[6] 798 F.2d at 676-678. Although the court of appeals found that petitioner proved conversion of its business records, 798 F.2d at 673, it reversed the punitive damage verdict, holding that petitioner failed to prove compensatory damages for conversion in addition to those underlying the contract claim.[7] *Id.*

Petitioner then filed a petition for rehearing and rehearing *en banc* pointing out (1) that the trial court instructed the jury that it must find petitioner established its right to compensatory damages before awarding punitive damages; (2) that state law guaranteed that a verdict winner would not be deprived of its judgment as a result of an ambiguity in a jury verdict;[8] (3) that respond-

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[6] The court of appeals also held that the Virginia Supreme Court would not recognize an implied private cause of action under the state's Unfair Insurance Practices Act, 6A Va. Code § 38.1-49, *et seq.*, and that the punitive damage verdict could not stand on this ground. Since both predictions involve pure questions of state law, petitioner does not challenge either holding for purposes of this petition for certiorari. Petitioner also does not challenge the court of appeals' holding that it failed to prove fraud by clear and convincing evidence under state law.

[7] The court of appeals further commented that conversion was not factually bound to the contract breach, 798 F.2d at 673. Respondent never raised this contention on appeal or during the proceedings before the trial court.

[8] Petitioner also pointed out that the Virginia Supreme Court would soon decide whether compensatory tort damages must be proved in addition to those in an interrelated contract breach to sustain a punitive damage award. *See Jefferson Coals, Inc.* v. *Eagle Energy, Inc.*, Record No. 860031 (appeal awarded July 28, 1986). Petitioner included a copy of the appeal certificate in the addendum to its petition and urged the court of appeals to remand the case to the trial court to allow the parties to avail themselves, if necessary, of the Virginia Supreme Court's binding interpretation of state law on this question.

ent never contended on appeal or during the proceedings before the trial court that conversion was not factually bound to the contract breach;[9] and (4) that the trial court had no opportunity to address the independent tort of slander which does not require proof of compensatory damages to support a punitive damage verdict.[10] Petitioner specifically cited both state law and this Court's decision in *Neely* v. *Martin K. Eby Construction Co.*, 386 U.S. 317 (1967), in support of its contention that it would be an extreme injustice to deny it a jury trial on the slander claim and an opportunity to clarify the verdict finding conversion. The court of appeals denied rehearing without explanation or opinion.

REASONS FOR GRANTING THE WRIT

This is not a case involving a jury award of excessive damages[11] or a trial court's grant of judgment n.o.v. following a jury verdict in favor of a plaintiff. On the con-

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[9] Had respondent raised this contention at trial, petitioner would have asked the trial court to submit to the jury, as part of the special verdict, the question whether conversion was committed in aid of the contract breach. The court of appeals denied petitioner any opportunity to have this factual issue considered by the trial court or a jury. In any event, punitive damages were recoverable if petitioner proved compensatory or nominal damages for conversion regardless of whether conversion was actually bound to the breach.

[10] Virginia law does not require proof of compensatory damages to support a punitive damage verdict for slander. *See Newspaper Publishing Corp.* v. *Burke*, 216 Va. 800, 805, 224 S.E.2d 132, 136 (1976). The district court was deprived of any opportunity to even consider the cause of action for slander because the court of appeals declined to remand the case for further proceedings.

[11] At no point during the appeal did respondent claim that the jury verdict was excessive. Its sole claim was that punitive damages could not be recovered in any amount.

trary, this case presents a setting in which the parties tried their case before a jury that found for petitioner, and in which the trial court summarized in a carefully detailed post-trial opinion the reasons why the jury verdict was not only proper but also inevitable. The court of appeals did not find a single error in the trial court's recitation of the facts or its conclusion that respondent's bad faith had been proved by uncontradicted evidence. 798 F.2d at 670.

The court of appeals did not disturb the trial court's decision upholding the jury verdict on the tort of conversion. Instead, it declared that petitioner failed to prove compensatory damages in connection with the tort of conversion and, therefore, could not recover punitive damages. Despite the fact that the trial judge expressly declared that he erred in denying petitioner the right to proceed on its slander claim and the fact that respondent did not challenge this declaration, the court of appeals disregarded the slander cause of action entirely. As a result, petitioner has never had an opportunity to have either the trial court or a jury pass on the merits of its slander claim.

As explained below, petitioner submits that the decision by the court of appeals ignores the teaching of this Court in *Neely* v. *Martin K. Eby Construction Co.*, 386 U.S. 317 (1967), because it deprived petitioner—the verdict winner—of a claim that the trial court specifically found had merit after conducting the trial on other claims. As a result of the court of appeals' ruling, petitioner was denied the right to trial by jury guaranteed by the Seventh Amendment.

The court of appeals' decision further denied petitioner its right to a new trial following an ambiguous verdict, despite state law holding that a verdict winner in the same

position should not be denied recovery simply because a verdict is not as clear as an appellate court would like. Without citing any authority for using its own standard rather than state law, the court of appeals implicitly followed prior decisions in the circuit holding that a federal court should apply federal law in every diversity setting when deciding whether to take a case from a jury. Petitioner submits that the court of appeals' approach is overbroad and incorrect under the *Erie* doctrine, and that it is inconsistent with the holdings of this Court and those of at least two other circuits. By granting review, this Court can clarify a serious conflict among the circuits as to the relationship of federal and state law with respect to the burden of persuasion.

A. The Court Of Appeals Misapplied This Court's Decision In *Neely* v. *Martin K. Eby Construction Co.*, 386 U.S. 317 (1967), By Ordering Judgment For Respondent Without Affording Petitioner a New Trial On A Cause Of Action Which The Trial Court Stated Had Been Mistakenly Taken Away From The Jury.

In *Neely* v. *Martin K. Eby Construction Co.*, 386 U.S. 317 (1967), this Court examined the factual setting in which a verdict winner loses on appeal but may have an additional ground to support his claim that has not been litigated. The plaintiff in *Neely* successfully litigated a wrongful death action in the district court, where the defendant's motions for a directed verdict and judgment n.o.v. were denied. On appeal, the defendant prevailed. This Court stated that under these circumstances a plaintiff with an additional meritorious claim should have an opportunity to raise it. The Court cited Fed. R. Civ. P. 50(d) and stated that the verdict winner may raise the claim in his petition for rehearing or petition for certiorari. 386 U.S. at 329-330.

In the instant case, petitioner advised the court of appeals in its petition for rehearing that its cause of action for slander had not been litigated. Petitioner cited authority clearly indicating that compensatory damages need not be proved under state law to support a punitive damage verdict.[12] Thus, petitioner complied with the procedure established by this Court in *Neely*, but the court of appeals both misapplied and ignored it. *See also*, *Weade* v. *Dichmann, Wright & Pugh, Inc.*, 337 U.S. 801, 808-809 & n.8 (1949).

This Court has not had the occasion to revisit *Neely* in almost twenty years. Although the plaintiff in *Neely* did not assert a claim either on rehearing or certiorari suggesting a new trial ground, petitioner has done so both in the court of appeals and again in this Court. The trial court recognized its error in dismissing the slander claim, but had no way of correcting it since petitioner prevailed on the jury verdict in any event. Only when the court of appeals overturned the trial court's judgment did the slander claim become crucial. When the court of appeals declined to remand this claim, it denied petitioner any opportunity to have it addressed at all and left petitioner remediless. Petitioner finds itself in the anomalous position of possessing a viable claim declared meritorious by the trial court, but which it cannot have decided on the merits. This dilemma is exactly what *Neely* intended to avoid.

B. The Court Of Appeals' Refusal To Remand The Slander Claim For Consideration On The Merits Denied Petitioner Its Seventh Amendment Right To Trial By Jury.

Ordinarily, a litigant whose claim is dismissed by a trial court may appeal to the court of appeals and seek reversal

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[12] See, e.g., Zayre, Inc. v. *Gowdy*, 207 Va. 47, 147 S.E.2d 710 (1966); *Newspaper Publishing Corp.* v. *Burke*, 216 Va. at 805, 224 S.E.2d at 136.

of the dismissal order. An exception arises, however, when the litigant has other claims that remain in the trial court and fully prevails on them. This Court has established that a successful litigant may not appeal or cross-appeal from a decision awarding everything sought in the lower court. *See New York Telephone* v. *Maltbie*, 291 U.S. 645, 646 (1934). Thus, even had the trial court failed to recognize its error in refusing to permit amendment of the complaint to include the slander claim, petitioner could not have appealed that ruling to the court of appeals. The fact that the trial court recognized its error in its post-trial opinion did not give petitioner a right of appeal, a point the court of appeals apparently overlooked. 798 F.2d at 671.

When the court of appeals reversed the punitive damage verdict and refused to remand the case for further proceedings in the trial court, it effectively deprived petitioner of the opportunity for a jury trial on the slander claim. This result deprived petitioner of its right to trial by jury guaranteed by the Seventh Amendment. The deprivation is substantial and especially unfortunate in view of the trial court's post-trial opinion clearly stating that the slander claim is extremely meritorious.

The court of appeals' approach disregards the importance of a litigant's right to a jury trial on the merits of a claim. As this Court stated in *Cone* v. *West Virginia Pulp & Paper Co.*, 330 U.S. 212 (1947), "a litigant should not have his right to a new trial foreclosed without having had the benefit of the trial court's judgment on the question." *Id.* at 217. In the instant case, the trial court's judgment was made known—i.e., that petitioner's slander claim was meritorious. But, the court of appeals effectively directed a verdict on the claim without having been asked to do so and in the face of petitioner's specific request for remand

so that its claim could be decided on the merits.[13] Petitioner asks this Court to hold that a court of appeals may not deny a verdict winner's right to trial by jury on the merits of a claim that the trial court did not find it necessary to reach.

C. The Court Of Appeals Violated The *Erie* Doctrine As Developed By This Court When It Refused To Give Petitioner A New Trial That Would Have Been Given Under State Law Following An Ambiguity In A Jury Verdict.

The record in this case conclusively establishes that the trial court, presided over by a Virginia judge applying Virginia law, instructed the jury, with respect to the tort claims on which punitive damages were sought, that if petitioner "is entitled to be compensated for its damages," then the jury "may also" award punitive damages. The trial court's reference to "its damages" obviously refers to compensatory damages on the tort claims since it held prior to trial that respondent waived any arson defense to the contract claim and directed the jury to return a verdict on the stipulated value of petitioner's warehouse. Thus, the jury had to find that petitioner proved entitlement to compensatory damages for conversion before it could award punitive damages. But, the court of appeals, applying Virginia law as no state court ever had previously or has since, held that petitioner had not adequately proved compensatory damages for conversion to support the punitive damage verdict.

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[13] *Cone* prohibited a court of appeals from entering judgment in favor of a party who had not moved for judgment n.o.v. in the trial court. The court of appeals effectively accomplished in the instant case what this Court prohibited in *Cone*. *See also, Globe Liquor Co.* v. *San Roman*, 332 U.S. 571 (1947).

Both petitioner and the trial court relied upon the logical and reasonable proposition that as long as the jury found that actual damages were proved it could award punitive damages for conversion.[14] This was and is Virginia law, and the instruction that the trial court gave was similar to the one that had just been approved four years earlier by the Virginia Supreme Court.[15]

The court of appeals apparently found that petitioner could not recover punitive damages in federal court because it only asked the jury to find, rather than to award, compensatory damages arising from the conversion.[16] This additional requirement—that compensatory damages be awarded—was not required by state law; state law required only that the jury find actual damages before awarding punitive damages. Under this Court's decision in *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64 (1938), and its progeny, the court of appeals had no basis for insisting upon more specific findings with respect to compensatory damages than a state court would have required.

If, however, there was any ambiguity in the jury verdict with respect to the finding of actual damages, state law

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[14] *See generally, Peacock Buick, Inc.* v. *Durkin*, 221 Va. 1133, 1137, 277 S.E.2d 225, 227 & n.3 (1981), which approved a jury instruction in a conversion case that permitted a verdict for punitive damages only upon a finding of actual damages.

[15] *See Peacock Buick, Inc., supra*, note 15.

[16] The court of appeals may have assumed that the jury's failure to award compensatory damages on the conversion claim meant that petitioner had not proved to the jury's satisfaction compensatory or even nominal damages on that claim. Any such assumption is not in accord with the trial court's instruction or this Court's holding in *Iacurci* v. *Lummus*, 387 U.S. 86 (1967), and at least warrants remand for clarification of any ambiguity in the jury verdict.

requires that the verdict winner be given the opportunity for further proceedings. In *Zedd* v. *Jenkins*, 194 Va. 704, 74 S.E.2d 791 (1953), the plaintiff successfully litigated a claim for alienation of affection and criminal conversion, but the jury returned a verdict for punitive damages only. The Viginia Supreme Court held that the plaintiff was entitled under those circumstances to have the case remanded for a determination of whether compensatory or nominal damages supported the punitive damage award. In *Zedd*, the Virginia Supreme Court was concerned that the verdict "was illegal in that it contained an assessment of punitive damages without finding that plaintiff was entitled to any compensatory, or even nominal, damages." 194 Va. at 708.

Zedd is important for two reasons: First, it established more than thirty years before the instant case was decided that a plaintiff who obtains a punitive damage award is entitled to that award without any specific award for compensatory damages; even a finding of nominal damages is sufficient. Second, *Zedd* established that if there is any doubt about whether the jury found nominal or actual damages, the plaintiff is entitled to a remand for further proceedings.

The court of appeals ignored *Zedd* and rejected petitioner's request for remand.[17] Apparently, the court of

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[17] The remand would have afforded the trial court, which instructed the jury on the law and conducted the instructions conference with the parties' counsel, an opportunity to determine that there was no ambiguity and that the jury had, in fact, found actual damages. In light of the trial court's findings of undisputed fact, it might even have directed a verdict that compensatory or nominal damages had been proved. Alternatively, the trial court might have conducted a new trial limited to the question whether there were actual or nominal damages as a result of conversion.

appeals believed that it had authority to enter final judgment under Fed. R. Civ. P. 50 notwithstanding *Zedd*. The court of appeals' approach to federal—state relations is consistent with a line of cases it has decided beginning with *Davis Frozen Foods, Inc.* v. *Norfolk Southern Rwy.*, 204 F.2d 839, 842 (4th Cir. 1953). These cases hold that federal law determines whether a diversity claim should be taken from the jury and decided by the court. *Wratchford* v. *S. J. Groves & Sons, Co.*, 405 F.2d 1061 (4th Cir. 1969) and continues with the decision in the instant case.

Petitioner submits that the court of appeals approach is inconsistent with this Court's decisions in *Cities Service Oil Co.* v. *Dunlap*, 308 U.S. 208 (1939), *Palmer* v. *Hoffman*, 318 U.S. 109 (1943), *Guaranty Trust Co.* v. *York*, 326 U.S. 99 (1945), and *Byrd* v. *Blue Ridge Rural Electric Corp.*, 356 U.S. 525 (1958). These cases either expressly or impliedly stand for the proposition that a federal court of appeals may not change the elements that a plaintiff must prove on a state law claim in a diversity case. This authority establishes that a federal court may not deny a plaintiff the chance guaranteed by state law to correct any ambiguity in a verdict. The court of appeals' approach is also in conflict with the decisions of the Seventh Circuit in *Lykos* v. *American Home Insurance Co.*, 609 F.2d 314 (7th Cir. 1979) and *McMahon* v. *Eli Lilly & Co.*, 774 F.2d 830 (7th Cir. 1985), and the decision of the Eighth Circuit in *Crossman* v. *Trans World Airlines*, 777 F.2d 1271 (8th Cir. 1985). These cases hold that a federal court must follow state law in deciding whether to take an issue away from a jury.

Petitioner further submits that the court of appeals misapplied this Court's decision in *Hanna* v. *Plumer*, 380 U.S. 460 (1965). There is nothing in the Federal Rules of Civil Procedure that suggests, let alone requires, that a

litigant be denied a remand for clarification of a verdict. The court of appeals' approach finds no support in Fed. R. Civ. P. 50(d) and is inconsistent with this Court's interpretation of Rule 50(d) in *Neely, supra*. This Court in *Neely* provided a mechanism for the court of appeals to do exactly what the Virginia Supreme Court would have done in the instant case.[18] When the court of appeals departed from the requirements of state law, it created both an unnecessary and undesirable conflict between federal and state law.

The court of appeals' approach is also inconsistent with the First Circuit's in *Marshall* v. *Mulrenin*, 508 F.2d 39 (1st Cir. 1974). The First Circuit held in *Marshall* that this Court's decision in *Hanna* does not require application of the federal rules of procedure in such a rigid fashion that would impair a substantive state interest. In short, the court of appeals created a substantial conflict in federal—state relations in the instant case without there being any apparent tension between Fed. R. Civ. P. 50 and Virginia law.

Had the instant case been tried in the state trial court where it was originally filed, petitioner would not have been denied an opportunity to clarify the jury verdict. That the denial in this case resulted because the court of appeals declined to defer to established state law indi-

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[18] This Court stated in *Neely* that "where the court of appeals sets aside the jury's verdict because the evidence was insufficient to send the case to the jury, it is not so clear that the litigation should be terminated." 386 U.S. at 327. The Court further stated that where the trial court caused the insufficiency the verdict winner would be entitled to a new trial. *Id*. Thus, petitioner would be entitled to a new trial under both federal and state law.

cates an insensitivity to the principles of *Erie* and other decisions of this Court.

CONCLUSION

Petitioner submits that the issues presented in this case are of great importance, both with respect to federal procedure and federal—state relations. Petitioner respectfully asks this Court to grant the petition and to reverse the decision of the court of appeals for the reasons stated herein.

Respectfully submitted,

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APPENDIX

APPENDIX
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 85-1759(L)

A & E SUPPLY COMPANY, INC.,

Appellee,

v.

NATIONWIDE MUTUAL FIRE INSURANCE COMPANY,

Appellant.

No. 85-1780

A & E SUPPLY COMPANY, INC.,

Appellant,

v.

NATIONWIDE MUTUAL FIRE INSURANCE COMPANY,

Appellee.

Appeal from the United States District Court for the Western District of Virginia, at Big Stone Gap. Glen M. Williams, District Judge. (C/A 81-0140).

Argued: February 6, 1986 Decided: August 15, 1986

Before ERVIN and WILKINSON, Circuit Judges, and HOUCK, United States District Judge for the District of South Carolina, sitting by designation.

W. Charles Waddell, III and S. D. Roberts Moore (Guy M. Harbert, III; Gentry, Locke, Rakes & Moore; Howard C. McElroy; White, Elliott & Bundy on brief) for Appellant/cross-appellee; Eugene K. Street (Thomas R. Scott, Jr.; Street, Street, Street, Scott & Bowman on brief) for Appellee/cross-appellant.

WILKINSON, Circuit Judge:

This case presents a familiar problem in insurance law. The insured sustained a financial loss for which the policy promised indemnification. The insurer denied coverage, contending without factual support that the insured was responsible for the catastrophe. In the subsequent lawsuit, the insured recovered the proceeds due and also received punitive damages, which it had sought on the theory that the insurer's breach constituted several independent, wilful torts. The insurer now appeals from this punitive, noncontractual award. We find that the insured did not prove the alleged fraud or the alleged conversion and that Virginia law would not recognize either the tort of bad faith refusal to honor a first-party insurance obligation or an implied private right of action under the state's unfair insurance practices statute. We therefore reverse that portion of the judgment awarding punitive damages.

I.

In the late evening of October 27 and the early morning of October 28, 1980, a fire completely destroyed the building of the A & E Supply Company, a mining equipment business in Buchanan County, Virginia. Owned and operated by brothers Larry Fletcher and Terry Lee Fletcher, A & E had purchased from the Nationwide Mutual Fire Insurance Company a policy that provided $150,000 in protection for the building and $250,000 in protection for its contents. A & E immediately notified Nationwide of the loss and gave to Nationwide what invoices, receipts, and tax returns had survived the fire.

Nationwide examined these documents and investigated the events of October 27-28. On March 12, 1981, Nationwide unreasonably refused to pay A & E, charging that the Fletchers had intentionally set the fire.

Nationwide did not relay its unfounded suspicions to law enforcement authorities for proper investigation, an admitted violation of the Arson Reporting Immunity Act. Va. Code § 27-85.3 *et seq.* Nationwide did, however, tell the creditors of A & E that the Fletchers had burned the building to collect on their insurance policy. These allegations severely limited the Fletchers' access to credit while Nationwide's cancellation of all A & E policies limited the Fletchers' access to insurance and Nationwide's refusal to return the A & E documents limited the Fletchers' access to information. Together the actions prevented resuscitation of the mine supply business and pressured the Fletchers to settle the A & E insurance claim quickly and unfavorably.

Instead, A & E sued Nationwide for breach of the insurance contract, conversion of the business records, acquisition of the records by false pretenses, fraud, slander, trespass, intentional infliction of emotional distress, bad faith dishonor of a first-party insurance obligation, and violation of the Virginia Unfair Insurance Practices Act, Va. Code § 38.1-49 *et seq.*[1] Because Nationwide had in May 1981 remitted $66,000 on the policy to the co-insured Borg-Warner Acceptance Corporation, the district court held that Nationwide had waived its arson defense, and the court accordingly granted a partial summary judgment of liability on the contract claim. *A & E Supply Co.* v.

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[1] Title 38.1 of the Virginia Code defined the relations of insured and insurer at the time of the coverage denial and the ensuing complaint. Virginia has since repealed title 38.1 and substituted a new insurance code in Title 38.2 of the Virginia Code, effective July 1, 1986. Under Va. Code § 1-16, this repeal does not "in any way whatever . . . affect . . . any right accrued, or claim arising before the new law takes effect." Our decision therefore addresses the rights of A & E under Title 38.1.

Nationwide Mutual Fire Insurance Co., 589 F.Supp. 428 (W.D. Va. 1984). Nationwide does not appeal from this ruling. Also before trial, the district court dismissed as improperly pleaded the A & E claims of slander, trespass, and intentional infliction of emotional distress. A & E does not appeal from those rulings.

From May 30, 1984 to June 12, 1984, a jury in the Western District of Virginia heard testimony and arguments about the compensatory damages due on the policy and about the punitive damages sought on the basis of Nationwide's conduct. The jury returned a directed verdict for $32,069.79 in coverage on the stipulated value of the building and returned a verdict for $188,966.09 in coverage on the contested value of the inventory. The jury also found in special verdicts that Nationwide had converted the business records of A & E, had obtained these records by false pretenses, had committed fraud, had acted in bad faith, and had engaged in unfair trade practices. Finding further that Nationwide had been malicious, the jury granted the request of A & E for $500,000 in punitive damages.[2]

Nationwide moved on all counts for a new trial or for judgment notwithstanding the verdict. The district court conditionally granted a new trial on the count pertaining to the state unfair trade practices act and granted judgment notwithstanding the verdict on the count alleging fraud. The court denied all of Nationwide's other motions. *A & E Supply Co.* v. *Nationwide Mutual Fire Insurance Co.*, 612 F.Supp. 760

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[2] A & E had moved under Fed.R.Civ.P. 15(a) to amend its complaint in order to ask for more punitive damages, a request that the district court denied and that A & E now pursues on appeal. We do not address this assignment of error, however, because of our conclusion that A & E was entitled to no punitive damages.

(W.D. Va. 1985).[3] Nationwide now concedes the judgment for compensatory damages, costs, and interest. It appeals from the judgment for punitive damages.

II.

Damages for breach of contract in Virginia normally "are limited to the pecuniary loss sustained." *Kamlar Corporation* v. *Haley*, 224 Va. 699, 299 S.E.2d 514, 517 (1983), *quoting Wright* v. *Everett*, 197 Va. 608, 90 S.E.2d 855, 860 (1956). The measure of damages is related to the exchange of risk and obligation in the agreement itself. The duty of each party toward the other is what that party has promised and covenanted. In a sense, each party has contracted for some outer limit to its liability.

It would skew the predictability necessary for stable contractual relations if a breaching party were suddenly subject to the more open and unanticipated duties and damages imposed by the law of tort. Most courts, and certainly Virginia courts,

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[3] At the same time, A & E had moved under Fed.R.Civ.P. 60(b)(6) for relief from the judgment preventing recovery of its attorneys' fees pursuant to Va. Code § 38.1-32.1. The court denied this petition on the reasoning that § 38.1-32.1 applied to an "individual" who is a natural person but did not extend to corporations. *A & E Supply Co.* v. *Nationwide Mutual Fire Insurance Co.*, 612 F.Supp. 760, 776-777 (W.D. Va. 1985). The Virginia General Assembly, however, has subsequently stated that "'Individual,' as used in this section, shall mean and include any person, group, business, company, organization, receiver, trustee, security, corporation, partnership, association, or governmental body, and this definition is declaratory of existing policy." Va. Code § 38.2-209. This legislative construction of Va. Code § 38.1-32.1 is entitled to significant weight in the interpretation of an ambiguous statute. *Cf. Seatrain Shipbuilding Corp.* v. *Shell Oil Co.*, 444 U.S. 572, 596 (1980). On its authority, we reverse the decision that A & E is ineligible under § 38.1-32.1 and remand to the district court for further consideration of attorneys' fees.

have thus not recognized an exception to the general rule of damages, even when the breaching party acts with an alleged malicious motive. The circumstances surrounding the dissolution of contractual relations are so frequently beset by strain and suspicion that perceptions of improper motive on the part of an opposing party are commonplace. Breach of contract would thus routinely give rise to an action in tort, with its attendant incentive of a punitive award. The Virginia Supreme Court has noted that "the overwhelming weight of authority continues to resist this tendency." *Kamlar Corp.* v. *Haley*, 299 S.E.2d at 517.

The general rule of contractual damages in Virginia admits but one exception. Only if the breach establishes the elements of "an independent, wilful tort," may it support an award of punitive damages. *Id.* In this case, the societal interest in the deterrence and punishment of wrongdoing may be implicated apart from any breach of contract. Viewed from this perspective, an "independent tort" is one that is factually bound to the contractual breach but whose legal elements are distinct from it.

A & E Supply has sought in this litigation to establish "an independent, wilful tort" on the part of Nationwide and to place itself within the exception. It argues that the jury and the district court correctly identified two such independent wilful torts—conversion and bad faith refusal to pay a first-party insurance claim—and contends that the district court erred in overturning the jury on two others—fraud and violation of the Virginia Unfair Insurance Practices Act. While we sympathize with the plight of plaintiff and agree with the district court that the conduct of Nationwide Mutual Fire Insurance Company was discreditable, we cannot find in the above litany of torts one that both applies to the circumstances of this case and that Virginia law would recognize as an independent basis for the award of punitive damages.

III.

A & E first seeks to uphold the award of punitive damages through proof of the familiar independent, wilful torts of fraud and conversion. Virginia law defines actual fraud as the knowing misrepresentation of a material fact to another person, whose reasonable reliance on the misrepresentation results in damage. *Packard Norfolk, Inc.* v. *Miller*, 198 Va. 557, 95 S.E.2d 207, 210 (1956). "The general rule is that fraud must relate to a present or a pre-existing fact, and cannot ordinarily be predicated on unfulfilled promises or statements as to future events." *Soble* v. *Herman*, 175 Va. 489, 9 S.E.2d 459, 464 (1940). A plaintiff may recover for actual fraud by showing reasonable reliance on a promise made by a defendant who had no intention of performing, *Colonial Ford Truck Sales, Inc.* v. *Schneider*, 228 Va. 671, 325 S.E.2d 91 (1985), but the plaintiff must prove all of the elements of fraud by clear and convincing evidence, *Martin* v. *Williams*, 194 Va. 437, 73 S.E.2d 355, 359 (1952).

That evidence is absent here. A & E argues that Nationwide's agent made fraudulent misrepresentations immediately after the fire to Larry Fletcher that "I think we can help you" and that Nationwide might "possibly" pay quickly on the claim. A & E also says that it entrusted its records to Nationwide in the belief that "as quick as they can get these records estabished, that they would have a settlement, or a partial settlement for us to where we could get back in business quickly." But such tentative statements to Larry Fletcher, made soon after the fire had ended and the investigation had begun, were more perfunctory reassurances than promises of payment. As the district court noted, A & E could not reasonably have relied on a belief that Nationwide had at this early point made any decision on the claim. Furthermore, the delivery of the A & E documents to Nationwide was required by the insurance contract and did not demonstrate reliance on the insurer's preliminary expectations of coverage. The district

court properly concluded that the evidence failed to substantiate the allegations of fraud.

A slightly different path leads to the same conclusion about the allegations of conversion.[4] A & E did prove that Nationwide had, in withholding A & E documents, wrongfully interfered with the company's rights to its own business records. *Cf. Buckeye National Bank* v. *Huff & Cook*, 114 Va. 1, 75 S.E. 769, 772 (1912) (defining conversion as "any wrongful exercise or assumption of authority, personally or by procurement, over another's goods, depriving [the other] of their possession"). But these elements of conversion cannot alone sustain the judgment granting punitive damages. Under Virginia law, an award of compensatory damages "is an indispensable predicate for an award of punitive damages, except in actions for libel and slander." *Gasque* v. *Mooers Motor Car Co.*, 227 Va. 154, 313 S.E.2d 384, 388 (1984). *See also Peacock Buick, Inc.* v. *Durkin*, 221 Va. 1133, 277 S.E.2d 225, 227 & n.3 (1981) (approving jury instruction in conversion suit that permitted verdict for punitive damages only upon finding of actual damages). This principle required A & E to buttress its conversion case with proof that the dispossession involved a palpable loss.

Again, the necessary evidence is absent here. A & E has claimed actual damages exclusively through Nationwide's failure to pay on the insurance contract. Its damages stemmed from this breach of contract, not from the alleged tort of conversion. The allegations of conversion, furthermore, describe tortious conduct that was extraneous to the breach of contract. Nationwide did not refuse to return the A & E records until April 29, 1981, more than six weeks after Nationwide

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[4] Although the jury returned separate verdicts on conversion and on the acquisition of property by false pretenses, both parties have recognized that the tort of conversion, extending to any wrongful act of procurement, subsumes the allegations of false pretenses. We accordingly treat the two counts together and find that, for the same reason, neither theory may support an award of punitive damages.

had formally rejected the insurance claim. The wrongful retention of property was not factually bound to the breach but to the efforts of Nationwide to prove its position in the ensuing litigation. A & E did not request the return of documents until it had initiated suit. It would undermine the rule of *Kamlar Corp.* v. *Haley* if subsequent disputes over evidence were to translate into the tort of conversion sufficient to support a punitive damages award in an action for contractual breach. A & E, which recovered its documents under a pre-trial order, has not alleged or proved any other actual damages from the conversion. The award of punitive damages accordingly may not rest on the conversion count.

IV.

A & E also claimed at trial that the requisite support in tort for an award of punitive damages could be found in its right to recover from Nationwide under the Virginia Unfair Insurance Practices Act, Va. Code § 38.1-49 *et seq.* Bound by the decision in *Morgan* v. *American Family Life Assurance Co. of Columbus*, 559 F.Supp. 477 (W.D. Va. 1983), the district court held that the statute implied a private cause of action in tort for insureds against insurers who had violated the Act. The jury returned a verdict of liability, but the district court then ruled that an insured could recover only for repeated violations of the Act. Because the court had suppressed evidence of such consistent conduct, it overturned the verdict and conditionally granted a new trial on the claim of unfair practices. *A & E Supply Co.* v. *Nationwide Mutual Fire Insurance Co.*, 612 F.Supp. 760, 774-775 (W.D. Va. 1985). On appeal, we first examine the premise in *Morgan* v. *American Family Life Assurance Co.* Not obliged to follow that precedent, we conclude that the Virginia Unfair Insurance Practices Act does not establish a private cause of action. We therefore vacate the conditional order for a new trial and remand with instructions to enter judgment for Nationwide on the statutory count.

The Virginia legislature enacted its Unfair Insurance Practices Act to define all practices that constitute "unfair or decep-

tive acts or practices" and to prohibit "the trade practices so defined or determined." Va. Code § 38.1-49. The legislature based the Act on a model statute drafted by the National Association of Insurance Commissioners, an example that has been followed by many other states. *See* Comment, *Insurers and Third-Party Claimants: The Limits of Duty*, 48 U.Chi.L.Rev. 125, 146 n.75 (1981). The Act forbids various insurance practices, including failure in bad faith to settle claims for which liability is reasonably clear. *See* Va. Code § 38.1-52.9(6). To enforce these regulations, the statute delegates to the State Corporation Commission the authority to promulgate rules, to investigate insurers, to conduct hearings, and to impose sanctions. Va. Code §§ 38.1-53 to 38.1-56. The Commission, acting largely through the Insurance Commissioner, may order insurers to cease and desist from prohibited practices, may levy penalty fines, and may suspend or revoke insurance licenses. Va. Code §§ 38.1-55 to 38.1-56. The statute guarantees Supreme Court review of final Commission orders, Va. Code § 38.1-56.1, but does not expressly create or preclude a private right of action against insurers who have committed proscribed trade practices.[5]

The federal district court in *Morgan* v. *American Family Life Assurance Co.*, 559 F.Supp. at 483-85, addressed this

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[5] The Act provides at Va. Code § 38.1-57.1 that "no order of the Commission under this article shall in any way relieve or absolve any person affected by such order from any liability under any other laws of this Commonwealth." This section does not authorize the A & E lawsuit, much as Va. Code § 8.01-221 "does not create any new rights of action but instead preserves any existing right of action that an injured person may have against a wrongdoer who has previously been the subject of statutory penalties for his misconduct." *Morgan* v. *American Family Life Assurance Co. of Columbus*, 559 F.Supp. 477, 484 (W.D. Va. 1983). *See also Hortenstine* v. *Virginia-Carolina Ry. Co.*, 102 Va. 914, 47 S.E. 996 (1904). As the court in *Morgan* v. *American Family Life* observed, 559 F.Supp. at 485, neither provision answers the question of whether an implied right of action exists under the Unfair Insurance Practices Act.

silence through *Cort* v. *Ash*, 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975). The Virginia Supreme Court has not, however, adopted the *Cort* rationale for finding an implied private right of action under federal law to the interpretation of state legislation. As a further matter, federal courts should be reluctant to read private rights of action into state laws where state courts and state legislatures have not done so. Without clear and specific evidence of legislative intent, the creation of a private right of action by a federal court abrogates both the prerogatives of the political branches and the obvious authority of states to sculpt the content of state law.

It is clear that the Virginia Supreme Court would not read the Unfair Insurance Practices Act to create a private right of action in tort. The Court has long regarded the state legislature as a repository of sovereign powers, whose dispensation must in any context be strictly construed. Describing "the doctrine of implied powers" in *Commonwealth* v. *County Board of Arlington County*, 217 Va. 558, 232 S.E.2d 30, 42 (1977), the Court said that "the rule is clear that where a power is conferred and the mode of its execution is specified, no other method may be selected; any other means would be contrary to legislative intent and, therefore, unreasonable." The Unfair Insurance Practices Act confers a power to redress insurer misconduct by organizing a system of administrative oversight with appellate judicial review. Under the approach of *Commonwealth* v. *County Board of Arlington County*, a court may not add a regime of private lawsuits to this specified mode of executing the statutory purpose. To do so would be to violate the injunction that "the doctrine of implied powers should never be applied to create a power that does not exist or to expand an existing power beyond rational limits." *Id.* 232 S.E.2d at 42.

The disinclination of the Virginia Supreme Court to recognize an entitlement that has not clearly been legislated is also supported here by a due regard for other provisions that have clearly been legislated. *Cf. National Maritime Union of Amer-*

ica v. *City of Norfolk*, 202 Va. 672, 119 S.E.2d 307, 314 (1961) ("It is an elementary rule of statutory construction that all relative provisions of a legislative enactment must be considered and read together in construing one provision or section."). The Unfair Insurance Practices Act is but one part of the state insurance code, a statutory complex that fills more than four hundred pages of the Virginia Code. The enactment provides for extensive regulation of insurance rates, availability, and practices. Tensions among these goals are to be resolved by the State Corporation Commission, which Va. Code § 38.1-29 charges "with the execution of all laws relative to insurance and insurance companies." *Blue Cross of Virginia* v. *Commonwealth ex rel. State Corporation Commission*, 218 Va. 589, 239 S.E.2d 94, 96 (1977).

The measured concord within this program would likely be disrupted by the introduction of state and federal courts as decision-makers affecting only one dimension of interrelated insurance problems. The most casual glance at the action below shows the inconsistencies that would result. The punitive damages awarded by the jury greatly exceeded the penalties provided in the Act. Va. Code §§ 38.1-55 to 38.1-56 (penalty not to exceed $5,000 per violation and $50,000 aggregate for six-month period). The requirement that frequent commissions of unfair claim settlement practices under Va. Code § 38.1-52.9 exist for a statutory violation appears more consistent with continued regulatory oversight than an individual cause of action. The discordant effects of independent—and often inexpert—supervision of unfair trade practices by the jury encourages acceptance of the explicit statutory remedy as the exclusive statutory remedy. As one commentator has advised, "if the legislature has carefully chosen an enforcement mechanism to accomplish the legislative purpose by accommodating conflicting interests, the integrity of the overall statutory scheme requires restraint in implying private actions." Note, *Implied Causes of Action in the State Courts*, 30 Stanford L.Rev. 1243, 1253 (1978).

Our reading of Virginia law accords with the position of several state courts that the model unfair practices legislation

proposed by the National Association of Insurance Commissioners, as enacted in those states, does not create a private right of action. *See, e.g., Patterson* v. *Globe American Casualty Co.*, 101 N.M. 541, 685 P.2d 396 (Ct. App. 1984); *Seeman* v. *Liberty Mutual Insurance Co.*, 322 N.W.2d 35 (Iowa 1982); *Wilder* v. *Aetna Life & Casualty Co.*, 140 Vt. 16, 433 A.2d 309 (1981); *Scroggins* v. *Allstate Insurance Co.*, 74 Ill.App.3d 1027, 30 Ill.Dec. 682, 393 N.E.2d 718 (1979); *Cohen* v. *New York Property Insurance Underwriting Association*, 65 A.D.2d 71, 410 N.Y.S.2d 597 (1978); *Russell* v. *Hartford Casualty Insurance Co.*, 548 S.W.2d 737 (Tex. Civ.App. 1977); *Retail Clerks Welfare Fund Local No. 1049, AFL-CIO* v. *Continental Casualty Co.*, 71 N.J. Super. 221, 176 A.2d 524 (1961).[6] In deferring to administrative primacy as a limitation on the adjudicative role, we also parallel interpretation of the Federal Trade Commission Act, 15 U.S.C. § 41 *et seq.*, whose basic prohibition of "unfair or deceptive acts" is tracked by the Virginia statute. Because the substantive prohibitions of that statute were "inextricably intertwined with provisions defining the powers and duties of a specialized administrative body charged with its enforcement," courts have declined to imply any private right of action and have relied upon the regulatory scheme to police the industry. *See Holloway* v. *Bristol-Myers Corporation*, 485 F.2d 986, 989 (D.C. Cir. 1973). We believe that the Virginia Supreme Court, while following its unique line of precedent and reasoning, would share many of the

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[6] To be sure, some other states have found an implied cause of action in their versions of the model act. *Klaudt* v. *Flink*, 658 P.2d 1065 (Mont. 1983); *Jenkins* v. *J. C. Penney Casualty Insurance Co.*, 280 S.E.2d 252 (W. Va. 1981); *Royal Globe Insurance Co.* v. *Superior Court of Butte County*, 23 Cal.3d 880, 153 Cal. Rptr. 842, 592 P.2d 329 (1979). We belive that the Virginia Supreme Court would either distinguish these decisions as dependent on variations from the Virginia Code, *see e.g. Royal Globe Insurance Co.* v. *Superior Court*, 592 P.2d at 333 (noting textual difference between California and Virginia statutes), or would find the other decisions to be unpersuasive.

concerns discussed by these courts and would reach the same result. We therefore hold that the award of punitive damages to the A & E Supply Co. may not rest on a jury finding that Nationwide violated the Unfair Insurance Practices Act.[7]

V.

As a final "independent, wilful tort" on which to predicate punitive damages in accordance with *Kamlar Corp.* v. *Haley*, 224 Va. 699, 299 S.E.2d 514, 517 (1983), A & E points to the verdict against Nationwide on its refusal in bad faith to honor a first-party insurance obligation.[8] In denying Nationwide's motion for judgment notwithstanding the verdict, the district court ruled that Virginia would recognize such a tort and that A & E had proved the elements. No Virginia authority directly addressed these issues; the court predicted the course of state law by reference to the Virginia Unfair Insurance Practices Act, the duty of good faith in the performance of insurance contracts, and the established right of action for refusal in bad faith to honor a third-party insurance obligation. *A & E Supply Co.* v. *Nationwide Mutual Fire Insurance Co.*, 612 F.Supp. 760, 770-772 (W.D. Va. 1985). But as we have already explained, the Unfair Insurance Practices Act does not imply the availability of any remedies beyond those described in the statute. Similarly, the extrapolation from the duty of good faith and the analogy to the third-party precedent do not support

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[7] We note that the revised Unfair Insurance Practices Act, effective July 1, 1986, provides that "No violation of this section shall of itself be deemed to create any cause of action in favor of any person other than the Commission; but nothing in this subsection shall impair the right of any person to seek redress at law or equity for any conduct for which action may be brought." Va. Code § 38.2-510(B).

[8] An insurer's first-party insurance obligation is its duty to compensate the insured for direct losses within the policy coverage. An insurer's third-party insurance obligation is its duty to defend the insured against claims by another, injured party and to indemnify the insured for losses sustained through such claims.

the district court's conclusion. To the contrary, these considerations indicate that Virginia would join the jurisdictions that have declined to recognize a remedy in tort for refusal in bad faith to honor a first-party insurance claim. We therefore reject this last basis for the award of punitive damages.

All contracting parties owe to each other a duty of good faith in the performance of the agreement. *Restatement (Second) of Contracts* § 205 (1981). For Nationwide, this duty parallels the insurer's responsibility under Va. Code § 38.1-52.9(6) to attempt "in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear." The doctrinal roots of the obligation are notoriously elusive: one scholar has argued that actions for bad faith sound in "conequitort," suggesting the interaction among concepts of contract, equity, and tort. Holmes, *Inductions from a Study of Commercial Good Faith in First-Party Insurance Contracts*, 65 Cornell L.Rev. 330, 377 (1977). This case, however, requires us to define the duty within the parameters of Virginia law, for A & E may receive punitive damages if Nationwide's conduct was tortious but may not receive punitive damages if Nationwide's conduct was "only a breach of contract inspired by an ulterior motive." *Kamlar Corp.* v. *Haley*, 299 S.E.2d at 518.

We hold that in a first-party Virginia insurance relationship, liability for bad faith conduct is a matter of contract rather than tort law. The obligation arises from the agreement and extends only to situations connected with the agreement. *Cf. Reisen* v. *Aetna Life and Casualty Co.*, 225 Va. 327, 302 S.E.2d 529, 533 (1983) ("the existence of the [good faith] duty wholly depended upon a condition precedent, that is, coverage under the policy"). The nonconsensual nature of the duty does not necessarily remove it from the province of contract; the Virginia Supreme Court has long enforced similar bonds in contract despite an absence of an express promise among the parties. *See, e.g, Carpenter* v. *Virginia-Carolina Chemical Co.*, 98 Va. 117, 35 S.E. 358 (1900). Indeed, insofar as the obligation is imposed by Va. Code § 38.1-52.9, its status as a contractual

term is a routine application of Virginia principles. "It is an elementary rule of construction of insurance contracts that such a statutory provision is as much a part of the policy as if incorporated therein." *State Farm Mutual Automobile Insurance Co.* v. *Duncan*, 203 Va. 440, 125 S.E.2d 154, 157 (1962).[9]

The state law of tort, on the other hand, cannot so easily accommodate an action for bad faith performance in insurance contracts. Because every agreement involves some variation of the duty of good faith, the remedy would quickly expand beyond its original basis. As the Supreme Court of Utah noted in *Beck* v. *Farmers Insurance Exchange*, 701 P.2d 795, 800 (Utah 1985), courts adopting the A & E reasoning "appear to have had difficulty in developing a sound rationale for limiting the tort approach to insurance contract cases." Tort relief in this situation implies tort relief in similar commercial and employment cases. *See Seamen's Direct Buying Service, Inc.* v. *Standard Oil Co.*, 36 Cal.3d 752, 206 Cal. Rptr. 354, 686 P.2d 1158, 1166-67 & n.6 (1984). Virginia law, however, explicitly forecloses that possibility. In *Kamlar Corp. v. Haley*, the Virginia Supreme Court refused "to turn every breach of contract into a tort" and held that an employee did not state a tort claim by charging that his employer "was 'actuated by malicious motives' in breaching the contract of employment." 299 S.E.2d at 517, 518. We believe that the Supreme Court would reach the analogous conclusion that an insured does not state a tort claim by charging that an insurer was actuated by bad faith in breaching the contract of insurance. *Accord, Wallace* v. *Hartford Insurance Co.*, 583 F.Supp. 1108 (W.D. Va. 1984). The better authority supports that view. *See, e.g., Beck* v. *Farmers Insurance Exchange; Spencer* v. *Aetna Life and*

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[9] An acknowledgement that the statute creates contractually enforceable duties does not conflict with a determination that the statute creates no private right of action, for contractual interpretation and statutory construction are separate enterprises. The cause of action recognized here may be in many ways different from a cause of action derived in tort from the statute.

Casualty Insurance Co., 227 Kan. 914, 611 P.2d 149 (1980); *Lawton* v. *Great Southwest Fire Insurance Co.*, 118 N.H. 607, 392 A.2d 576 (1978).

Because the suit for bad faith performance is thus in effect an action on the insurance policy, "the provisions of the contract govern the measure of recovery rather than any rules applicable to cases sounding in tort," *Bickel* v. *Nationwide Mutual Insurance Co.*, 206 Va. 419, 143 S.E.2d 903, 905 (1965). For some types of breach, these provisions might successfully limit the available damages to the stated amount of indemnity. *See* Annot., 47 A.L.R.3d 314 (1973). But if an indemnitor has violated the contractual duty of good faith, the indemnitee may recover full general and consequential damages. *See Board of Supervisors of Stafford County* v. *Safeco Insurance Co. of America*, 226 Va. 329, 310 S.E.2d 445, 450 (1983) (predicating surety's liability for consequential damages on finding of bad faith default); *see also Beck* v. *Farmers Insurance Exchange*, 701 P.2d at 801-802; *Lawton* v. *Great Southwest Fire Insurance Co.*, 392 A.2d at 579-580; *Reichert* v. *General Insurance Co.*, 59 Cal. Rptr. 724, 428 P.2d 860, 864 (1967), *vacated on other grounds*, 68 Cal.2d 822, 69 Cal.Rptr. 321, 442 P.2d 377 (1968). Had A & E proved foreseeable losses, not susceptible to mitigation, resulting from Nationwide's bad faith refusal to pay, Virginia contract law would make A & E whole. The same principles of reimbursement will not support exemplary damages, however, for such an award is designed "not so much as compensation for the plaintiff's loss as to warn others, and to punish the wrongdoer." *Wright* v. *Everett*, 197 Va. 608, 90 S.E.2d 855, 859 (1956).

Permitting consequential damages within the scope of contract law lessens the incentive for an insurer to postpone satisfaction in hopes of pressuring the insured to accept a fraction of his due. *Beck* v. *Farmers Insurance Exchange*, 701 P.2d at 798. The distress that persons experience at times of personal or financial loss leaves them vulnerable to exploitation, a temptation that would be enhanced if the insurer's contractual liability

could never, as a matter of law, extend beyond the policy limits for even the most flagrant breach. *Lawton* v. *Great Southwest Fire Insurance Company*, 392 A.2d at 579 ("The policy limits restrict the amount the insurer may have to pay in the performance of the contract, not the damages that are recoverable for its breach."). Holding that the duties and obligations of the parties are contractual does not, therefore, absolve the insurer of the need to investigate claims, to settle promptly and fairly those that are covered, and to proceed generally in good faith as that term is defined in Va. Code § 38.1-52.9.

The definition of an insurer's responsibility through consequential damages in contract rather than punitive damages in tort is also consistent with the relationship between the first-party claims of A & E and the third-party claims in *Aetna Casualty & Surety Company* v. *Price*, 206 Va. 749, 146 S.E.2d 220 (1966). In *Aetna Casualty*, the Virginia Supreme Court held that a liability insurer must answer for a judgment in excess of the promised coverage if the insurer has in bad faith refused to settle within the policy limits on a claim against its insured. This approach is grounded in contract. *See* Comment, *Insurers' Liability for Excess Judgments in Virginia: Negligence or Bad Faith?*, 15 U.Rich.L.Rev. 153 (1980). The full judgment was due the insured for foreseeable losses resulting from the insurer's breach of the duty of good faith. Although the proper range of consequential damages may vary in insurance cases, *id.* at 161-162, the guiding principle of reimbursement for provable loss appears to be settled. No Virginia authority indicates that punitive damages are available in the third-party context. *Cf. Swiatlowski* v. *State Farm Mutual Auto Insurance Co.*, 585 F.Supp. 965 (W.D. Va. 1984) (withholding judgment on issue). Even less should punitive damages be recoverable for bad faith breach in the first-party context where the insured is not "wholly dependent upon the insurer to see that, in dealing with claims by third parties, the insured's best interests are protected." *Beck* v. *Farmers Insurance Exchange*, 701 P.2d at 799. The award to A & E on this basis must accordingly be reversed.

VI.

Like the implication of a private right of action under the Unfair Insurance Practices Act, creation of a cause in tort for bad faith refusal to settle an insurance claim carries profound consequences. On the one hand, these two actions may reduce delay and obstruction in recoveries by those insured. On the other, they may deter assertion even of the most legitimate defenses by insurers. These two actions—and the large punitive awards that potentially accompany them—would portend significant changes in standards of insurer conduct and costs of insurance coverage. Whether those effects bode good or ill is not for us to say. Virginia, through its courts and legislature, is the one to restructure its insurance industry, not the federal courts through implication of private rights of action under statute and creation of venturesome torts at common law.

Here the insured sued under the policy and recovered its proceeds. The punitive award is another matter. We cannot conclude that a particular instance of conduct on the part of a particular insurer authorizes us to undertake wholesale changes in Virginia insurance law. Examination of the various foundations for the punitive verdict in the law of tort persuades us that it cannot stand. That judgment is therefore

REVERSED.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 85-1759
No. 85-1780

A & E SUPPLY COMPANY, INC.,

Appellee,

v.

NATIONWIDE MUTUAL FIRE INSURANCE COMPANY,

Appellant.

FILED
Sep 26 1986
U.S. Court of Appeals
Fourth Circuit

Appeal from the United States District Court for the Western District of Virginia, at Big Stone Gap. Glen M. Williams, District Judge.

The appellee's petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of the Court requested a poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and suggestion for rehearing in banc are denied.

Entered at the direction of Judge Wilkinson, with the concurrence of Judge Ervin and Judge Houck, United States District Judge, sitting by designation.

For the Court,

/s/ John M. Greacen

JOHN M. GREACEN

CLERK